Supreme Court, U. S.
FILED
OCT 17 1975
MICHAEL RODAK, JR., CLERK

IN THE SUPREME COURT OF THE UNITED STATES

October Term 1975

No. 75-573

RICHARD L. ZWEIG, et al.,

Petitioners,

vs.

THE HEARST CORPORATION,

Respondent.

JERRY GREENFIELD, et al.,

Petitioners,

vs.

THE HEARST CORPORATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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RICHARD L. ZWEIG and
MURIEL BRUNO,

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vs.

THE HEARST CORPORATION,
a corporation,

Respondent,

JERRY GREENFIELD, individually
and as a representative of a
class of all persons similarly
situated,

Petitioner,

vs.

THE HEARST CORPORATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI

TO THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

The petitioners RICHARD L. ZWEIG, MURIEL BRUNO, and JERRY GREENFIELD respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on July 21, 1975.

OPINION BELOW

The opinion of the Court of Appeals, not yet reported, appears in the Appendix hereto. No opinions were rendered by the District Court for the Central District of California.

JURISDICTION

The judgment of the Court of Appeals for the Ninth Circuit was entered on July 21, 1975. This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

1. Does 15 U.S.C. §78(t)(a) eliminate respondeat superior as a vehicle for secondary liability under Section 10(b) the Securities Exchange Act of 1934 (15 U.S.C. §78(j)(b))?

2. Are the standards and criteria for determining the good faith of a "controlling person" different for broker-dealers than for persons and entities

other than broker-dealers, and, if there are different standards and criteria, what are they and how are they developed?

3. Did THE HEARST CORPORATION meet its duty of good faith as the "controlling person" of Alex N. Campbell in light of the fact that it took virtually no precautions to prevent his manipulation of the stock market and that its lack of knowledge of Mr. Campbell's activities was achieved by neglect?

STATUTORY PROVISION INVOLVED

United States Code, Title 15:

§78(t)(a). Liabilities of controlling persons.

Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

STATEMENT OF THE CASE

The jurisdiction of the District

Court was invoked because of exclusive federal jurisdiction of cases arising under the Securities Exchange Act of 1934 (15 U.S.C. §78 et seq.).

THE HEARST CORPORATION (hereinafter HEARST) publishes the Los Angeles Herald Examiner, a daily newspaper. Alex N. Campbell, a co-defendant below but not a party on appeal, is an employee of HEARST writing a daily financial column. While Mr. Campbell occasionally wrote about national companies and national issues, the basic format of his column was to write about companies in the Los Angeles area. On June 4, 1969, Campbell wrote, and the paper printed, a column about American Systems, Inc. The article was highly laudatory of American Systems, its management, products, and fiscal condition.

Undisclosed in the article was the fact that Campbell had purchased 5,000 shares of American Systems stock directly from the company shortly before the article was published.

The Campbell column about American Systems was published on June 4, 1969, and immediately the price and volume of shares traded rose dramatically. Campbell then sold a substantial portion of his American Systems stock the next day for a profit of more than 200 per cent. The value of the stock later fell off.

Petitioners RICHARD L. ZWEIG and MURIEL BRUNO were owners of two-thirds of the shares of a corporation which merged into American Systems. The merger, a stock for stock reorganization, closed on

June 9, 1969, with ZWEIG and BRUNO suffering damage when the price of American Systems stock was artificially inflated due to the June 4 column (ZWEIG and BRUNO were to receive $1,200,000.00 of American Systems stock, the number of shares to be determined by the average trading price of American Systems stock for the five days preceeding closing).

Petitioner JERRY GREENFIELD brought the action below individually and as a representative of all persons who purchased American Systems stock after June 4, 1969, and who were damaged by the artificially inflated price. The District Court has ruled that the action may not be maintained as a class action, a ruling which has just been appealed to the Ninth Circuit.

While other parties defendant are involved in this litigation, the matters before the Court concern only THE HEARST CORPORATION in its capacity as employer of Alex N. Campbell.

In each of the two cases, HEARST moved for summary judgment as to petitioners' claims under Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78(j)(b)) and Rule 10(b-5) of the Securities and Exchange Commission (17 C.F.R. Para. 240, 10(b-5)). Two grounds were asserted to support the motions:

1. HEARST has no liability under the agency principle of respondeat superior and it may be liable only as a controlling person under Section 20(a) of the Securities Exchange Act of 1934 (15 U.S.C. §78(t)(a)).

2. HEARST is not liable as a controlling person because it acted in good faith and had no knowledge of Campbell's trading activities.

Petitioners contended in the District Court and in the Court of Appeals that the common law principle of respondeat superior does (and should) apply in cases brought under Section 10(b) and Rule 10(b-5) and that the controlling person provision of Section 20(a) of the Securities Exchange Act of 1934 (15 U.S.C. §78(t)(a)) extends secondary liability beyond the agency relationship required for respondeat superior.

Petitioners also contended that HEARST

had not shown sufficient good faith as a controlling person even if that is the exclusive avenue of secondary liability. The issue with regard to HEARST's good faith is what kind of precautions are necessary, if any, in order to be acting in good faith. The law with regard to broker-dealers is fairly well established but the Court of Appeals for the Ninth Circuit held that different rules apply to controlling persons who are not broker-dealers.

This Petition for Writ of Certiorari follows the decision of the Court of Appeals affirming the District Court's granting of summary judgment to HEARST.

REASONS FOR GRANTING THE WRIT

1. THERE IS AN IRRECONCILABLE SPLIT AMONG THE CIRCUITS

The various Courts of Appeal have taken opposite positions on a question of great national importance. The legal question is whether Section 20(a) was intended to restrict or expand coverage of the Securities Exchange Act of 1934 (15 U.S.C. §78(t)(a)). The Ninth Circuit holds that respondeat superior was impliedly eliminated with the enactment of the controlling person provision of Section 20(a)(15 U.S.C. §78(t)(a)). The Fourth, Sixth, and Seventh Circuits take the opposite position. Johns Hopkins University v. Hutton, 422 F. 2d 1124 (4th

Cir. 1970); Armstrong, Jones & Co. v. Securities and Exchange Commission, 421 F. 2d 359 (6th Cir. 1970); Fey v. Walston & Co., Inc., 493 F. 2d 1036 (7th Cir. 1974). The Second Circuit recently joined the majority opposing the Ninth Circuit in Securities and Exchange Commission v. Management Dynamics, Inc., 515 F. 2d 801, 812-813 (2d Cir. 1975). Since all the decisions in conflict are recent, it is not likely that any new decision by a Court of Appeals will resolve the impasse.

In the case at bar, the Court of Appeals below was wrong, in light of Securities and Exchange Commission v. Management Dynamics, Inc., supra, when it listed the Second Circuit as favoring the exclusion of respondeat superior from application in actions under the Section

10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78(j)(b). Thus the Ninth Circuit stands alone in its holding that respondeat superior is pre-empted by the controlling person provision of Section 20(a).

2. THE ISSUE ON WHICH THE CIRCUITS ARE SPLIT IS ONE OF CONSIDERABLE NATIONAL IMPORTANCE

It has become axiomatic that the securities laws have broad application, both from congressional purpose and judicial application. Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972). Elimination of respondeat superior is inconsistent with a broad application.

Section 20(a) allows secondary liability outside the principal-agent relationship because it extends to any person who "controls" the primary tortfeasor. It is more restrictive than respondeat superior in that it provides a defense to liability if the controlling person acted in good faith and did not induce the violation. If one seeks a broad application, Section 20(a) and respondeat superior working together do, in fact, constitute an expansion over the common law principle of respondeat superior alone because liability under Section 20(a) may extend beyond the formal requirements of an agency relationship. Professor Alan R. Bromberg, an analyst of securities frauds, finds that Section 20(a) supplements the common law doctrine of agency. In speaking directly on this point he says, at Bromberg,

1 Securities Law: Fraud, Sec. 6.1 (100), p.107 at note 1:

> "An intermediary who is an agent makes his principal liable, on common-law precedents, for any violation committed by him within the scope of his authority. The principal may also be liable for the intermediary's act, even if agency in the common-law sense does not exist, when the principal is in control of the intermediary under the broad standards of SEA Section 20 ... On either of these bases, the principal may become responsible for any violation by the intermediary..."

In the case at bar, the Court of Appeals held that the test of a controlling person's good faith is less searching for persons outside the brokerage industry than it is for controlling persons in the brokerage industry itself. If that position is correct, the elimination of respondeat superior will have an increased effect in cases such as the case at bar because general agency law will be unavailable and lower standards will be used to determine the liability of the controlling persons.

The impact of financial news on the securities markets is readily obvious. HEARST argued below, and the Court of Appeals held, that a proper system of supervision and controls is a prerequisite to "good faith" only within the brokerage

industry. If the securities laws are to have broad application and if the remedial aspects of the securities laws are to have thorough effect, the impact of the financial press should not be treated so lightly. It is submitted that elimination of respondeat superior will reduce the effective range throughout which the remedies created by the Securities Exchange Act of 1934 should function. Private enforcement of the securities laws has received encouragement from the courts for the reason that it plays a major role in policing the securities industry. The chance to recover money one has lost is incentive to vindicate one's rights. Elimination of respondeat superior will dampen the incentive to the extent that it restricts the arena in which a defrauded investor may look for recovery. The broad

ranging remedial legislation of the Securities Exchange Act of 1934 (15 U.S.C. §78 et seq.) will have a restricted application if the holding of the Court of Appeals below is sustained because it will automatically insulate an entire class of persons who normally would be liable under the common law doctrine of agency.

With regard to the kinds of precautions necessary to maintain a controlling person's good faith, the Court of Appeals below held that broker-dealers are held to a high standard because of the duty to supervise provided in the 1934 Act (15 U.S.C. §78o(b)(5)(E)) and because of the opportunity to take advantage of the broker's position with the customer. The court then noted that it would be impractical to check every article of every journalist

for conflict of interest or accuracy. It is respectfully submitted that far more simple precautions are available, such as a guideline or policy that a journalist should not trade in the securities of companies he or she is writing about. That exact policy was instituted by HEARST after the incident in the case at bar even though such a policy received publicity in the Report of Special Study of Securities of the Securities and Exchange Commission, House Document No. 95, 88th Congress, 1st Session, Part 3, pages 65-102 (1963). The point here is that the kind of standards to be applied should be related to the opportunity for abuse rather than by category of business. In this regard, the test of good faith should question the area of reasonably forseeable danger and the precautions taken to prevent abuse.

It seems incongrous to say that no precautions are necessary because a particular journalist has not been known to abuse his or her position in the past.

Finally, this Court has not directly commented upon the issues herein. In Affiliated Ute Citizens v. United States, supra, the Court dealt with a question of secondary liability for securities fraud and held a secondary party liable without elucidating the reason therefor. The briefs of the parties and amicus curiae did not discuss respondeat superior or Section 20(a). The Court found that the bank, innocent of participation in the fraud, was liable for the fraud of its employees and that such liability was "coextensive" with that of the employees. It would appear then that Section 20(a)

is not the exclusive avenue of secondary liability because the liability of a controlling person is not coextensive with that of the controlled person. In the controlling person context there are always the questions of good faith and whether the conduct of the controlling person induced the fraud. Under respondeat superior these defenses are unavailable and the liability of the employer is truly coextensive with that of the employee. Moreover, the bank is not generally within the securities brokerage industry yet the Court did not consider different standards of good faith (if Section 20(a) were applied) as the Ninth Circuit suggests below. The fact that the Court has not directly discussed the issue of respondeat superior in this context, along with the question of criteria for determining the

"good faith" of a controlling person, makes the case appropriate for review.

CONCLUSION

The need for responsibility in the financial press, not because it is irresponsible but because of its enormous impact on the securities markets and the opportunities for abuse, makes this case perfect for review at this time. The fact that there is a split among the circuits on the issues in the case at bar provides an excellent reason for review because it is fairly clear that had the action been commenced in almost any other circuit the result would have been different.

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Ninth Circuit.

Respectfully submitted,

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APPENDIX

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

RICHARD L. ZWEIG and MURIEL BRUNO, Plaintiffs-Appellants, vs. THE HEARST CORPORATION, a corporation, Defendant-Appellee.	)	Case Nos. 74-1979 74-2028
JERRY GREENFIELD, individually and as a representative of a class of all persons similarly situated, Plaintiff-Appellant, vs. THE HEARST CORPORATION, Defendant-Appellee.	)	

Appeal from the United States District Court for the Central District of California

BEFORE: KOELSCH and CHOY, Circuit Judges, and McNICHOLS,* District Judge.

McNICHOLS, District Judge:

The above-captioned actions have, by prior order, been consolidated for appeal. The appellee in each case is the same and the controversies arose out of a single transaction. Appellants rely on precisely identical grounds for reversal.

For the purposes of this appeal, jurisdiction in the District Court was founded on 15 U.S.C. §78j(b) and 17 CFR §240.10b-5 (the familiar Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities and Exchange

*The Honorable Ray McNichols, Chief Judge, United States District Court for the District of Idaho, sitting by designation.

Commission promulgated under authority of the Act).[1/] Jurisdiction here is laid in 28 U.S.C. §1291.

FACTUAL BACKGROUND

The Hearst Corporation (hereinafter Hearst) publishes the Los Angeles Herald Examiner, a daily newspaper. One Alex A. Campbell, a co-defendant below, not a party to this appeal, is an employee of Hearst and the author of a financial column published five days a week in the Herald Examiner. On June 4, 1969, Campbell wrote, and the paper printed, a column concerning a corporation known as American Systems, Inc. The article tended

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1/ Counts alleging pendente jurisdiction for negligence and fraud under state and common law theories were also pled. With the dismissal of the federal jurisdiction counts, pendente jurisdiction failed as to Hearst.

to be laudatory of American Systems, its management, products, and fiscal condition. Undisclosed in the article was the fact that Campbell had recently invested in American Systems stock.

Subsequent to publication of the June 4 column, the price of American Systems stock rose dramatically. Campbell took advantage of the appreciated market and disposed of some or all of his stock. The value of the stock later fell off.

Plaintiffs alleged various theories of pecuniary damage through the fluctuation of the price of American Systems stock which fluctuation they attribute to the newspaper story. They contend that Campbell's conduct constituted actionable wrongdoing in violation of Section 10(b) and Rule 10b-5. Suit was instituted in each case against Campbell, Hearst and

others. Vicarious liability on the part of Hearst is claimed, based on the employment relationship.

Hearst promptly moved for summary judgment as to the claims under Section 10(b), supporting such motions with affidavits. Plaintiffs fully resisted the motions. Hearst prevailed, summary judgment was granted in each case, and this appeal was perfected.

Two issues are concisely delineated for review:

1. Did the District Court err in holding that Hearst had no vicarious liability under the agency theory of respondeat superior?
2. Did the District Court err in granting summary judgment in favor of Hearst, based on the

good-faith defense permitted by 15 U.S.C. §78t(a) (Section 20(a) of the Act of 1934)?

We deem it unnecessary to set out in haec verba the well-known proscriptions of Section 10(b) and Rule 10b-5 relative to the employment of any manipulative or deceptive devices in connection with the purchase or sale of any security. For the purposes of this appeal, we accept, without deciding, that plaintiffs have pled a meritorious Section 10(b) action.

The two issues faced on this appeal turn on an interpretation of the effect of Section 20(a) of the 1934 Act, which provides:

> "(a) Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any ruly or regulation thereunder shall also be liable jointly and severally with and to the same extent as such

> controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action."

The quoted portion of the Act is commonly referred to as the "controlling person" provision. Vicarious liability attaches to a controlling person or entity by operation of law except that a defense of good faith is provided where the controlling person did not directly or indirectly participate in the wrongful acts.

Both courts below concluded, we think correctly, that Hearst qualifies as a controlling person under Section 20(a).

The threshold issue to be dealt with concerns the effect of the adoption of Section 20(a) by the Congress on the long-established agency doctrine of respondeat

superior. Appellants contend that Section 20(a) was not intended to supplant the vicarious liability of an employer under agency theories, but provided an enlargement of liability to reach persons having responsibility but not easily fitted into any specific agency classification. Appellee, pointing to our holding in Kamen & Co. v. Paul H. Aschkar & Company, 382 F. 2d 689 (1967), cert. granted 390 U.S. 942, cert. denied, 393 U.S. 801, urges that in this Circuit the issue is foreclosed contra to appellant's position.

Kamen appears to be the forerunner of a series of cases in the various circuits treating with the liability of an employer where an employee violates Section 10(b). It was there held that Section 20(a), the controlling person provision, is to be applied to determine

such liability. The contention that the more stringent doctrine of respondeat superior remained effective to establish vicarious liability was rejected. This holding has far-reaching implications because of the exculpatory defense of good faith available under Section 20(a).

The Kamen decision has been much discussed, sometimes followed, on occasion distinguished, and other times rejected out of hand. As a result the circuits are not in full accord. The Supreme Court has not spoken on the issue, though the occasion has been afforded.

The Kamen rule is well established in this circuit. Hecht v. Harris, Upham & Co., 430 F. 2d 1202 (1970); Douglass v. Glenn E. Hinton Investments, Inc., 440 F. 2d 912 (1971); Jackson v. Bache & Co., Inc., 381 F. Supp. 71 (1974).

The Second Circuit is in accord. Lanza v. Drexel & Co., 479 F. 2d 1277 (1973); Securities & Exchange Commission v. Lum's, Inc., 365 F. Supp. 1046 (1973); Gordon v. Burr, 366 F. Supp. 156 (1973), partially modified on other grounds, 506 F. 2d 1080 (1974); Barthe v. Rizzo, 384 F. Supp. 1063 (1974).

The Fourth, Sixth and Seventh Circuits take a contra position. Johns Hopkins University v. Hutton, 422 F. 2d 1124 (4th Cir. 1970), (affirming the strongly presented arguments of Judge Frank Kaufman at 297 F. Supp. 1165); Armstrong, Jones & Co. v. Securities & Exchange Commission, 421 F. 2d 359 (6th Cir. 1970); Fey v. Walston & Co., Inc., 493 F. 2d 1036 (7th Cir. 1974).

Leading cases in the Eighth and Tenth Circuits, where Section 20(a) has been

held to support liability in Section 10(b) cases, do not specifically deal with the agency remedy question. Myzel v. Fields, 386 F. 2d 718 (8th Cir. 1967); Richardson v. MacArthur, et al., 451 F. 2d 35 (10th Cir. 1971).

Kamen provides the controlling authority on this appeal. We hold that the trial court correctly held that Hearst was not vicariously liable under the doctrine of respondeat superior and that, as to Hearst, liability, if any, was as a controlling person under Section 20(a).

We turn to the second specification of error, that of the propriety of the summary judgment entered on the issue of the defense of good faith made available by the terms of Section 20(a).

It is to be noted that there is no contention made that Hearst directly or

indirectly induced the act or acts of Campbell which form the basis of plaintiff's claim of Section 10(b) and Rule 10b-5 violations. We therefore face the narrow question of whether, under Rule 56, Federal Rules of Civil Procedure, the record discloses that there is no genuine issue as to any material fact to the end that Hearst would be entitled as a matter of law to summary judgment on the question of having "acted in good faith".

We are most cognizant of the strictures controlling the granting of summary judgment under Rule 56.

> " Summary judgment is proper only where there is no genuine issue of any material fact or where, viewing evidence and inferences which may be drawn therefrom in light most favorable to adverse party, movant is clearly entitled to prevail as matter of law." Stansifer v. Chrysler Motors Corporation, 487 F. 2d 59, 63 (9th Cir. 1973).

An examination of the facts developed by interrogatories and affidavits offered for and against appellants' motion for summary judgment is required. The source of those facts are to be found in affidavits of Donald Goodenow, Managing Editor of the Herald Examiner, and of George R. Hearst, Jr., Publisher of the paper, and in answers to separate interrogatories propound to and answered by Campbell and by Hearst.

The affidavits and the interrogatory answers do not raise any specific conflict and, indeed, the parties agree as to the basic facts. We therefore paraphrase the affidavits and interrogatory answers.

Mr. Goodenow, as Managing Editor, avers in essence that his duties required him to supervise the reporters; that Campbell had been employed for a number

of years;[2/] that Campbell chose his own subjects without suggestion from the newspaper; that at the time the article in question was published the employer was unaware of any financial interest Campbell may have had in American Systems, Inc.; that the newspaper never investigates the financial affairs of its employees, unless for cause; prior to publication of the article the paper had never received any complaints concerning any article written by Campbell; that, as a result of inquiries concerning the June 4, 1969 column, the Herald Examiner suspended publication of Campbell's articles and conducted an investigation; that at the conclusion of the investigation the newspaper reinstated

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2/ In his interrogatory answers Campbell states that he has worked for 30 years for the Herald Examiner in the Financial Department.

publication of Campbell's articles only after entering into an agreement that Campbell would not write about a company in which he had a financial interest and, further, would only write about companies listed on one of the two major Stock Exchanges.

Mr. Hearst, by affidavit, stated that he was on the Board of Directors of Hearst and had examined the stock transactions of the Company. He stated that the records reflected that Hearst had had no transactions in American Systems stock of any kind from February 1969 through October 1969.

Answers to interrogatories furnished the following supporting or additional facts: that Goodenow indeed was supervisor over Campbell; that the Managing Editor had the privilege of making changes

in Campbell's articles or otherwise edit the column; that Goodenow never had made a change in a column; that proofreaders made minor spelling and punctuation changes; that Campbell had worked for the financial department of the Herald Examiner for 30 years; that the June 4, 1969, column was published in the normal course of Hearst's business; that headlines and some grammatical changes are routinely made; that the newspaper expected Mr. Campbell, as well as all reporters, to prepare articles factually and truthfully, and that Goodenow had, prior to June, 1969, discussed this expectation with Campbell; and that Hearst made no attempt to verify Campbell's statements regarding the American Systems column prior to printing, but relied on Mr. Campbell to accurately report information relayed to him from such

companies in preparing his column.

Thus is the issue joined. Appellants contend that the record shows a total failure of Hearst to take any precautionary steps to guard against the alleged abuses by its employee; to furnish any guidelines or supervision to financial writers, and that its claimed good faith is in fact achieved only through the neglect of these obligations. They postulate, though no record was made in support, that the investing public relies on financial news published by the prestigious Hearst newspaper chain, as, it is said, Hearst well knows.

They urge therefore that (1) the evidence presented belies the good faith contention of Hearst, or (2) that as a minimum there exist genuine questions of fact as to this issue which militate

against determination by summary judgment.

Appellees, on the other hand, take the position they have demonstrated factually that Hearst (1) was not in the securities business, (2) did not at any relevant time deal in American Standards stock, (3) had no financial interest in that company, (4) relied on the integrity of Campbell, a thirty-year employee in the financial department, about whom no complaint had ever been made, and (5) immediately, upon notification of the instant occurrence, had instituted corrective steps. These facts are not in dispute, Hearst argues, and therefore the controversy in this posture merely required that the District Judge determine the legal effect of the undisputed facts. This, they contend, is the purpose of the summary judgment procedure.

It must be evident from the foregoing that in truth there is not presented a factual dispute between the parties. A search of appellants' briefs for any contrary contention is vain. They frequently allege that there is an issue of fact as to Hearst's good faith. This misses the mark. All of the material facts were before the Court below in undisputed form. The Court therefore properly entertained the Motion for Summary Judgment to determine whether or not, on those undisputed facts, Hearst, the moving party, was entitled to judgment as a matter of law. Stansifer v. Chrysler Motors Corporation, Supra; Doff v. Brunswick Corporation, 372 F. 2d 801 (9th Cir. 1967).

The question then narrows to a consideration as to whether or not, under the undisputed facts, Hearst was entitled to

prevail as a matter of law. Differently stated -- do the facts disclose as a matter of law that Hearst acted in good faith as that defense is contemplated by Section 20(a)?

Our research has not uncovered, and very competent and thorough counsel have not drawn our attention to, any case either on four squares with this case or offering controlling precedent.

Appellants, understandably, rely for precedential guidance as to what constitutes good faith under Section 20(a) on a number of Section 10(b) cases brought against broker-dealers engaged in the securities business. The rule evolving from these cases is rather well established. Excusing some generalization, these cases involve a factual situation in which a salesman, employee or other agent of a

licensed broker dealing in securities is alleged to have violated the provisions of either Section 10(b) or Rule 10b-5 in the sale or purchase of securities; the relationship between the broker and the alleged miscreant being within the controlling person category of Section 20(a).

With considerable unanimity the reported cases have required that to satisfy good faith it must be shown that the controlling person maintained and enforced a reasonable and proper system of supervision and internal control over controlled persons so as to prevent, so far as possible, violations of Section 10(b) and Rule 10b-5.

The courts of this Circuit, which have considered the question, are uniformly in accord with the foregoing general

rule covering broker-dealer situations. Hecht v. Harris, Upham & Co., 283 F. Supp. 417, 438-439 (N.D. Cal. 1968), partially modified on other grounds, 430 F. 2d 1202, 1211 (1970); Jackson v. Bache & Co., Inc., 381 F. Supp. 71, 96 (N.D. Cal. 1974).

Other circuit and district court holdings are in agreement. Fey v. Walston & Co., Inc., supra, at 1051; Lanza v. Drexel & Co., supra, at 1301; Richardson v. MacArthur, supra, at 42; Securities & Exchange Commission v. Lum's, Inc., supra, at 1064; Gordon v. Burr, supra, at 169; Moerman v. Zipco, Inc., 302 F. Supp. 439, 447 (E.D.N.Y. 1969), affirmed on opinion below, 422 F. 2d 871, petition for rehearing denied, 430 F. 2d 362; Moscarelli v. Stamm, 288 F. Supp. 453, 460 (E.D.N.Y. 1968).

The Securities Exchange Act of 1934

contains a provision authorizing the Securities and Exchange Commission to levy sanctions against a broker-dealer who fails to reasonably supervise those under his control so as to prevent violations of the Act. 15 U.S.C. §78o(b)(5)(E).

The rationale for holding broker-dealers to a duty to supervise those who personally deal with the investing public is self-evident. The broker-dealer derives financial gain directly geared to the sales of his broker-representative. Purchasers of securities frequently rely heavily for investment advice on the broker-representative handling the purchaser's portfolio. Such representatives traditionally are compensated by commissions in direct proportion to sales. The opportunity and temptation to take advantage of the client is ever present. To ensure the diligence

of supervision and control, the broker-dealer is held vicariously liable if the representative injures the investor through violations of Section 10(b) or the rules thereunder promulgated. The very nature of the vast securities business, as it has developed in this country, militates for such a rule as public policy and would seem to suggest strict court enforcement.

Can it logically be held that publishers of newspapers are to be held to a similar standard? Is there demonstrated any public policy need that would so dictate? It must be conceded that the financial page or pages of a large metropolitan newspaper have some influence on the investing public. But, to liken the relationship between a newspaper owner publishing financial news and a reader-

investor to the practically fiduciary relationship between the broker and his customer is to depart from reality.

Hearst's vicarious liability under Section 20(a) cannot be judged by the standards applied to a broker-dealer.

Some lesser standard amounting more nearly to culpability is indicated. A newspaper which requires its reporters to report facts fairly and accurately has a right initially to expect compliance. Unless somehow placed on notice that a particular writer has violated or may violate the requirement of fairness and accuracy, the newspaper may continue to safely anticipate compliance. Where the writer is one with thirty years of service with the paper and not the subject of any complaint during that period, the continued unquestioned publication of his articles

is justified. The practicalities of operating a large daily newspaper make it impossible for each item of news or reported interview to be rechecked by supervising editors. If the column or newstory prepared and submitted by the columnist or reporter does not, on its face, reveal impropriety, the very nature of the newspaper business prohibits cross-checking.

These are the factors to be taken into consideration in order to determine the issue of good faith on the part of a newspaper owner as a controlling person under Section 20(a).

Summary judgment has, as one of its most important goals, the elimination of waste of the time and resources of both litigants and the courts in cases where a trial would be a useless formality. Courts must, of course, proceed with

caution in determining litigation by summary judgment; this is especially true where grave, important and novel questions of law are involved. However, the mere fact that the issues may be complex is not a valid reason to deny summary judgment when there is no genuine issue as to any material fact, and the movant is entitled to judgment as a matter of law.

Upon a full review of the undisputed facts presented by this record, and after considering all inferences which may be drawn from those facts in the light most favorable to appellants, we are convinced that Hearst is entitled as a matter of law to a favorable judgment on the issue of good faith

It follows that the courts below properly granted summary judgment.

The judgments appealed from are affirmed.

Service of the within and receipt of a copy thereof is hereby admitted this ..... day of November, A.D. 1975.

Supreme Court, U. S.
FILED
NOV 19 1975
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1975
No. 75-573

RICHARD L. ZWEIG, *et al.*,

Petitioners,

vs.

THE HEARST CORPORATION,

Respondent.

JERRY GREENFIELD, *et al.*,

Petitioners,

vs.

THE HEARST CORPORATION,

Respondent.

Brief in Opposition to Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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Parker & Son, Inc., Law Printers, Los Angeles. Phone 724-6622

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vs.

THE HEARST CORPORATION,

Respondent.

Brief in Opposition to Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Respondent The Hearst Corporation hereby opposes the Petition for a Writ of Certiorari filed by Petitioners Richard L. Zweig, Muriel Bruno and Jerry Greenfield and respectfully urges that it be denied.

Opinions Below.

The opinion of the Court of Appeals, which has not been reported as yet, is set forth in Appendix A to the Petition.

Counterstatement of the Case.

Alex N. Campbell was employed to write daily financial columns in the Los Angeles Herald Examiner, a daily newspaper published by The Hearst Corporation. Petitioner is attempting to invoke liability upon The Hearst Corporation because Campbell purchased stock in a company about which he had written an article. Although Respondent does not controvert Petitioner's statement of the case, additional facts are necessary to review the question here presented.

In examining the issue of whether The Hearst Corporation acted in good faith, the Ninth Circuit considered these facts:

1. Campbell had worked for the Los Angeles Herald Examiner for thirty (30) years.
2. Campbell chose his own subjects for his articles without suggestion from the Los Angeles Herald Examiner.
3. The Los Angeles Herald Examiner was unaware of any financial interest Campbell may have had in American Systems, Inc.
4. The Los Angeles Herald Examiner never investigates the financial affairs of its employees unless for cause.
5. Prior to the publication of the article regarding American Systems, Inc., the Los Angeles Herald Examiner had never received any complaints concerning any article written by Campbell.
6. The Los Angeles Herald Examiner expected Campbell as well as all its reporters, to prepare articles factually and truthfully, and Donald Goodenow, Managing Editor of the Los Angeles Herald Examiner and Campbell's Supervisor, had discussed this expectation with Campbell prior to the publication of the article concerning American Systems, Inc.

7. The Los Angeles Herald Examiner was not in the securities business.
8. The Los Angeles Herald Examiner did not at any relevant time deal in American Systems' stock.
9. The Los Angeles Herald Examiner had no financial interest in American Systems, Inc.
10. The Los Angeles Herald Examiner relied on the integrity of Campbell, a thirty (30) year employee in the Financial Department, about whom no complaint had ever been made.
11. Immediately upon notification of Campbell's ownership of stock in American Systems, Inc., The Los Angeles Herald Examiner suspended publication of Campbell's articles, conducted an investigation, and thereafter reinstituted publication of Campbell's articles only after entering into an agreement that Campbell would not write about a company in which he had a financial interest and, further, would only write about companies listed on one of the two major stock exchanges.

Introduction.

The Petitioners originally instituted their actions against not only Respondent and Alex Campbell but also officers and directors of American Systems, Inc. The Hearst Corporation removed itself from the litigation by obtaining a summary judgment which was af-

firmed on appeal. As to the remaining Defendants and the underlying lawsuits, the District Court in the Greenfield case has denied class status to the action and has dismissed the lawsuit for Plaintiff's failure to prosecute. The District Court in the Zweig case has granted Campbell's motion for dismissal.

Respondent in seeking a denial of the Petition, makes the following contentions:

1. The facts of the instant action are so unusual and unique that they should not form the basis for a definitive rule of law in the securities field.
2. There is not a substantial disparity of opinion among the Circuit Courts of Appeals on the primary issue herein.
3. The primary issue here involved has so rarely confronted the Circuit Courts that it cannot be said to be an important question of federal law.
4. The application of the good faith defense in the subject case is appropriate in the unique factual setting and is not in conflict with any principle espoused by any other circuit.

The Decision of the Court of Appeals Is Based Upon the Complex, Unusual and Unique Facts of the Instant Case Which Is an Inappropriate Context for the Formulation of a Definitive Rule of Law in the Securities Field.

Respondent contends that the facts of the instant case are *sui generis* and that it would be ill-advised and inappropriate to use this factual context as a basis for developing a standard of liability in the securities field. As the Ninth Circuit noted in its decision:

> "Our research has not uncovered, and very competent and thorough counsel have not drawn our attention to, any case either on four squares with this case or offering controlling precedent."

The Ninth Circuit, having found the myriad of cases of the securities field to be of no assistance, correctly espoused a decision based on the facts intrinsic to the case before it. The propriety of limiting the scope of its decision because of the nature of the case before it rather than attempting to make an expansive rule of law is further supported by the position taken by the Second Circuit in *Securities and Exchange Commission v. Management Dynamics Inc.* 515 F.2d 801 (2nd Cir. 1975) wherein it stated at page 813:

> "We need not decide today whether the entire corpus of agency law is to be imported into the securities acts for all purposes. We hold only that, in the circumstances of this case, the SEC in this enforcement action was entitled to an injunction. . . . We stress again, however, that we intimate no view as to other cases which may involve a lesser employee, actions for damages, other agency principles, or respondeat superior, which may be broader than the apparent authority involved here. Such cases may involve entirely different policy considerations that are best consigned to future resolution."

Research has uncovered no case considering the potential liability of a newspaper of general circulation for a securities act violation in connection with the publication of news articles. A precedential decision on such a question would appear of little value to the lower courts who are constantly confronted with cases involving broker-dealers, and not others only peripherally involved in securities regulation.

There Is No Substantial Disparity Among the Circuit Courts of Appeals as to the Standard of Vicarious Liability.

An examination of the decisions in the Circuit Courts of Appeals as to employers' liability for their employees' violations of the Securities Exchange Act of 1934 does not support Petitioners' contention that there is an irreconcilable split among the Circuits. The leading case for the proposition that Section 20 (the so-called "controlling person" provision) of the 1934 Act exclusively determines the liability of an employer is *Kamen and Co. v. Paul H. Aschkar and Company,* 382 F.2d 689 (9th Cir. 1967), *cert. granted,* 390 U.S. 942, 88 S.Ct. 1021, 19 L.Ed.2d 1129, *cert. denied,* 393 U.S. 801, 89 S.Ct. 401, 21 L.Ed.2d 85 (1968). The Ninth Circuit has abided by that decision in the subsequent cases of *Hecht v. Harris, Upham & Co.,* 430 F.2d 1202 (9th Cir. 1970) and *Douglass v. Glenn E. Hinton Investments Inc.,* 440 F.2d 912 (9th Cir. 1971).

The Second Circuit has considered whether the principle of *respondeat superior* should be used to determine an employer's liability for its employees' violations of the 1934 Act, and has rejected the application of this common law theory of liability, holding that the only standard of liability is the "controlling person" section of the 1934 Act. *Lanza v. Drexel & Co.,* 479 F.2d 1277 (2nd Cir. 1973) and *Gordon v. Burr,* 506 F.2d 1080 (2nd Cir. 1974). It is true, as Petitioners contend, that the Second Circuit in *SEC v. Management Dynamics, supra,* upheld an injunction against a broker-dealer, based upon the application of agency principles.

However, the court specifically stated that its decision was limited to the facts of that particular case and to the remedy sought, stating at page 813:

> "We need not decide today whether the entire corpus of agency law is to be imported into the securities acts for all purposes. We hold only that, in the circumstances of this case, the SEC in this enforcement action was entitled to an injunction against Carno because of Nadino's trading activity. . . . We stress again, however, that we intimate no view as to other cases which may involve lesser employees, actions for damages, other agency principles, or respondeat superior, which may be broader than the apparent authority involved here. Such cases may involve entirely different policy considerations that are best consigned to future resolution."

The Third Circuit, in accord with the Ninth Circuit, recently held that the "controlling person" provision of the 1934 Act is the standard of liability for employers, and not *respondeat superior.* In *Rochez Brothers Inc. v. Rhoades* (September 29, 1975) CCH ¶95,313, the Court examined the legislative history of the 1934 Act and concluded that ". . . the principles of agency, *i.e., respondeat superior,* are inappropriate to impose secondary liability in a securities violation case." It further held that liability cannot be found under Section 20(a) unless it can be shown that the defendant-employer was a culpable participant in the acts constituting the fraud.

In the Fourth Circuit, the only decision concerning the vicarious liability of an employer for a violation

of a federal securities law is *Johns Hopkins University v. Hutton,* 422 F.2d 1124 (4th Cir. 1970). In that case, the court was confronted with a violation of Section 17a of the 1933 Act. It held that the doctrine of *respondeat superior* should be applied in the particular case despite the "controlling person" section of the 1933 Act. Since the court in *Johns Hopkins* was not presented with a violation of the Securities Act of 1934, it has not decided the issue here presented. Reconciliation of the decision in *Johns Hopkins* with the position of Respondent herein is found in the fact that the "controlling person" provision of the 1933 Act specifically limits its application to persons liable under Sections 77K or 77L, which do not involve Section 17(a) of the 1933 Act. The comparable provision, Section 20(a) of the 1934 Act, does not have this limitation. Further, the court in *Johns Hopkins* relied upon the legislative history of the 1933 Act in reaching the decision therein. Obviously, the court did not examine the legislative history of the 1934 Act and its "controlling person" provision which, according to the courts in *Rochez Brothers Inc. v. Rhoades, supra, Lanza v. Drexel, supra, SEC v. Lum's Inc.,* 365 F.Supp. 1046 (S.D.N.Y. 1973), and *Gordon v. Burr, supra,* clearly indicates that Section 20 of the 1934 Act replaces common law theories of vicarious liability and that the application of principles of agency would be inconsistent with the legislative history of the 1934 Act.

The Sixth Circuit in *Armstrong, Jones and Co. v. Securities and Exchange Commission,* 421 F.2d 359 (1970), *cert. denied,* 398 U.S. 948, 90 S.Ct. 2172, 26 L.Ed.2d 543 (1970) was confronted with a situation wherein certain employees of a broker-dealer violated sections of the 1934 Act prohibiting the use of fraudulent statements in connection with the sale of any securities. The Commission had sanctioned the broker-dealer for the willful acts of its employees. Relying on an administrative decision of the SEC, the Sixth Circuit agreed with the position of the Commission that a broker-dealer may be sanctioned for the willful violation by its employees under the doctrine of *respondeat superior.* The Sixth Circuit did not discuss the "controlling person" provision of the 1934 Act, nor did it discuss any legislative history of the 1934 Act, nor did it comment on any decision of any other Circuit regarding the question of "*respondeat superior* v. controlling person" under the 1934 Act. These omissions would indicate that the Sixth Circuit restricted its decision to the situation before it and did not attempt to establish a rule of law in its Circuit on the question here involved.

The Seventh Circuit, in *Securities and Exchange Commission v. First Securities Company of Chicago,* 463 F.2d 981 (7th Cir. 1972), *cert. denied,* 409 U.S. 880, 93 S.Ct. 85, 34 L.Ed.2d 134 (1972), considered claims of fraudulent activity founded upon two separate causes of action, one based upon the common law liability and the other based upon violations of the Securities Act of 1934. As to the securities law violation, the Court specifically held that Section 20(a) of the 1934 Act provided for the exclusive remedy of the claimants in a Section 10(b) action. The Court found that Nay, as the President and employee of First Securities, was in fact controlled by First Securities within the meaning of Section 20(a), and therefore vicarious liability was imposed by that Section. For the same result see also *Sennot v. Rodman and Renshaw,* 474 F.2d 32 (7th

Cir. 1973), *cert. denied,* 414 U.S. 926, 94 S.Ct. 224, 38 L.Ed.2d 160 (1973). Subsequently, the Seventh Circuit, in *Fey v. Walston and Company Inc.,* 493 F.2d 1036 (7th Cir. 1974), considered the liability of an employer and based such liability on a theory of *respondeat superior.* However, the Court cited *SEC v. First Securities Company* in support of its position which would appear to be entirely inconsistent with that prior decision. Due to the conflicting nature of these two circuit cases, it does not appear that the Seventh Circuit has made a final determination as to the standard of liability of employers for employees' violations of the Securities Exchange Act of 1934.

The Eighth Circuit in *Myzel v. Fields,* 386 F.2d 718 (8th Cir. 1967), *cert. denied,* 390 U.S. 951 (1968), considered the liability of an employer under the 1934 Act, and, as the court in *Rochez v. Rhoades, supra,* noted, indicated that liability for such securities act violations was governed by Section 20(a) and not by agency theories.

The remaining Circuit which has examined Section 20(a) is the Tenth Circuit in the case of *Richardson v. MacArthur* 451 F.2d 35 (10th Cir. 1971). In that case, the Court held a life insurance company liable pursuant to Section 20(a) of the Securities Exchange Act of 1934 for the acts of one MacArthur who was selected by the company to develop the life insurance business in California. MacArthur's activities and authority, reviewed in detail by the Court, seemed sufficient to establish the principal-agent relationship. Notwithstanding this agency nexus, the Court relied on Section 20(a) to impose vicarious liability.

The Infrequency of Circuit Court Decisions Belies Petitioners' Contention That the Issue Involved Herein Is One of Considerable National Importance.

A review of the Circuit Court decisions since the enactment of the Securities Exchange Act in 1934 reveals that the issue here involved has been considered on not more than fourteen occasions. This fact becomes more significant when considering the volume of litigation that has been generated by the 1934 Act.

One might well expect that if the debate on this issue had assumed the proportions suggested by Petitioners, more cases would have arisen and a significant divergence of opinion could be found in reported cases. In addition, the resolution of this issue in the context in which it is here presented would seemingly be of little precedential value because of the uniqueness of the facts and the presumed limited applicability of the decision based on these facts. Therefore, before adopting a comprehensive rule of law for liability of employers, the Circuit Courts of Appeals should be given additional time, especially in broker-dealer cases, to examine and determine the ramifications of holding an employer liable for the acts of its employees.

Petitioner Points to No Conflict Among the Circuits or Question of National Importance With Respect to the Circuit Court of Appeals' Application of the Good Faith Defense.

In their brief, Petitioners present two questions concerning the defense of good faith asserted by The Hearst Corporation. However, Petitioners' brief is devoid of any authorities indicating that the Ninth Circuit has taken a position in conflict with another Circuit or that the Ninth Circuit inappropriately applied

the defense of good faith. The underlying nature of Petitioners' attack on this point consists of an attack on the factual findings of the Ninth Circuit in this particular case. The facts relied on by the Court below clearly support the application of the good faith defense and render it unnecessary to articulate a definitive rule for the application of that defense for all cases. It is respectfully suggested that it would be premature for this Court to enunciate a complete statement with respect to what constitutes the good faith defense before the circuits review a sufficient quantum of such disputes that founding principles and policies can be carefully identified and scrutinized.

Conclusion.

Respondent respectfully submits that the Petition for Writ of Certiorari be denied as there exists no substantial conflict in the decisions of the Circuit Courts of appeals on the "controlling person v. *respondeat superior*" issue of vicarious liability under the Securities Exchange Act of 1934. Further, the nature of the parties and the uniqueness of the facts herein suggest neither an issue of compelling national interest or a need for establishing a universal principle of law.

Respectfully submitted,

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